FILED
AUG 22 19
HAROLD B. WILLEY

IN THE

Supreme Court of the United States

October Term, 1955.

No. 254

FRANCIS R. SMITH, COLLECTOR OF INTERNAL REVENUE,

Petitioner,

v.

THE CURTIS PUBLISHING COMPANY.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit.

BRIEF FOR RESPONDENT IN OPPOSITION.

FRANCIS H. SCHEETZ,
20th Floor, Fidelity-Phila. Trust Bldg.,
Philadelphia 9, Pa.,
Attorney for Respondent.

August 17, 1955.

International, 236 Chestnut St., Phila. 6, Pa.

INDEX TO BRIEF.

	Page
Opinions Below	1
Jurisdiction	1
Question Presented	2
Statute and Regulations Involved	2
Statement	2
Reasons for Not Granting the Writ	4
Argument	5
The Niles Group	9
The GMAC Group	10
Conclusion	14

TABLE OF CITATIONS.

Cases.

Page

Allen v. Atlanta Metallic Casket Co., 197 F. 2d 460 (C. A. 5, 1952), aff'g 99 F. Supp. 104 (1951) 9

Belden Mfg. Co. v. Jarecki, 192 F. 2d 211 (C. A. 7, 1951), aff'g 95 F. Supp. 539 (1951) 7,9

Bijou Theatrical Enterprise Co. v. Menninger, 127 F. Supp. 16 (D. C. E. D. Mich., 1954) 9

Commercial Credit Co. v. Hofferbert, 93 F. Supp. 562 (1950), aff'd per curiam, 188 F. 2d 574 (C. A. 4, 1951) 10, 11

The Curtis Publishing Company v. Smith, 220 F. 2d 748 (C. A. 3, 1955), aff'g 124 F. Supp. 508 ...1, 5, 6, 8, 9, 11, 12, 13

Follansbee Steel Co. v. United States, — F. Supp. —, (D. C. W. D. Pa., 1954) reported at par. 49,108, Supp. Vol., CCH Fed. Tax Rep. 9

Gamble-Skogmo, Inc. v. Kelm, 112 F. Supp. 872 (D. C. Minn., 1953) .....,.....10, 11

General Motors Acceptance Corp. v. Higgins, 161 F. 2d 593 (C. A. 2, 1947), rev'g 60 F. Supp. 979 (1945), cert. den., 332 U. S. 810 (1947) 6, 7, 8, 10, 11, 12

Knudsen Creamery Co. of California v. U. S., 121 F. Supp. 860 (D. C. S. D. Calif., 1954) 10

The H. Kobacker & Sons Co. v. U. S., 124 F. Supp. 211 (D. C. N. D. Ohio, 1954) 10

Motor Finance Corporation v. U. S., — F. Supp. —, (D. C. N. J.), decided July 2, 1954, and reported at par. 49,057, Supp. Vol., CCH Fed. Tax Rep. 9

Niles-Bement-Pond Co. v. Fitzpatrick, 213 F. 2d 305 (C. A. 2, 1954), rev'g 112 F. Supp. 132 (1953) 5, 7, 8, 12, 13

S. S. Pierce Co. v. U. S., 127 F. Supp. 396 (D. C. Mass., 1954) 5, 9, 12

Shamrock Oil & Gas Co. v. Campbell, 107 F. Supp. 764 (D. C. Tex., 1952) 7,9

Sharon Steel Corp. v. United States, — F. Supp. —, (D. C. W. D. Pa., 1955) reported at par. 49,107, Supp. Vol., CCH Fed. Tax Rep. 10

TABLE OF CITATIONS (Continued).

Cases (Continued).

	Page
Stuyvesant Town Corp. v. U. S., 111 F. Supp. 243 (Ct. Cls. 1953), Cert. den. 346 U. S. 864 (1953)	10
United Airlines Inc. v. United States, — F. Supp. —, (D. C. N. D. Ill., 1955) reported at par. 49,088, Supp. Vol., CCH Fed. Tax Rep.	9
U. S. v. Ely & Walker Dry Goods Co., 201 F. 2d 584 (C. A. 8, 1953), aff'g 107 F. Supp. 298	7, 9
U. S. v. General Shoe Corp., 117 F. Supp. 668 (D. C. M. D. Tenn., 1953)	10
United States v. Leslie Salt Co., 218 F. 2d 91 (C. A. 9, 1954), aff'g 110 F. Supp. 680 (1953)	4, 5, 10, 11, 12

Statutes.

	Page
Internal Revenue Code of 1939, 53 Stat. 195:	
Sec. 1800 (26 U. S. C. A. 1800)	2
Sec. 1801 (26 U. S. C. A. 1801)	2

Miscellaneous.

	Page
Hearings Before the Committee on Finance, United States Senate, Eighty-third Congress, Second Session	13

IN THE

Supreme Court of the United States.

October Term, 1955.

No. .

FRANCIS R. SMITH, COLLECTOR OF INTERNAL REVENUE,

Petitioner,

v.

THE CURTIS PUBLISHING COMPANY.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

BRIEF FOR RESPONDENT IN OPPOSITION.

OPINIONS BELOW.

The District Court's findings of fact, discussion and conclusions of law are reported at 124 F. Supp. 508. The per curiam opinion of the Court of Appeals is reported at 220 F. 2d 748.

JURISDICTION.

Jurisdiction is as set forth in the Petition.

QUESTION PRESENTED.

Were the District Court and Court of Appeals correct in deciding that the promissory notes, delivered by the taxpayer to evidence term bank loans in conventional lending operations by the loan departments of commercial banks, were not debentures and therefore were not subject to the documentary stamp tax under Sections 1800 and 1801 of the Internal Revenue Code of 1939?

STATUTE AND REGULATIONS INVOLVED.

The Statute and Regulations involved are as set forth in the Petition at pages 2-4.

STATEMENT.

Petitioner's summary of the facts is incomplete as it makes no reference to the testimony presented at the trial and omits other relevant facts found by the District Court, including additional facts concerning term bank loans and the Curtis loan in particular.

Instruments such as the Curtis notes here involved are generally known in both commercial and investment banking circles as promissory notes, and not as corporate securities or debentures. (R. 11b.) Such notes are not readily marketable and are not intended to be. They are not sold, although they can be hypothecated with the Federal Reserve Bank in the event the lending bank needs reserves. (R. 12b.) They are carried in the lending bank's commercial loan department and are quite different from investment securities which must be carried in the bank's investment portfolio and which must conform to certain ratings under regulations of the Federal Reserve Bank, the Federal Deposit Insurance Corporation and State Banking Departments. (R. 13b, 32a.)

Typical commercial loan department operations include both term loans, i.e. loans having maturities of more than one year, and short term paper. Short-term as well as long-term loans are frequently collateralized, while

others are unsecured. Term loans are made to both small and large businesses alike, ranging from modest amounts to the bank's legal lending limit. (R. 31a, 3b-6b.) Loans beyond the lending limit of a single bank, and often larger loans, are handled either by direct participation by several lending banks, as in the Curtis loan, or through participations issued by the lending bank.

In commercial banking practice, before an unsecured commercial loan is made, the borrower is usually required to meet certain credit requirements designed to protect the lending bank against credit risks. Before a loan is approved, the bank must be satisfied as to the character and integrity of the borrower, the financial condition of its business, the circumstances of the economic cycle and other matters bearing on the credit risk. Generally, such credit protective features are not reduced to writing in the case of sixty or ninety-day loans, but they are nevertheless an integral part of the lending transaction. In general, the same requirements must be satisfied when short-term loans are renewed, and the bank by reason of the short maturity is in a position to protect itself against deteriorating credit by insisting on payment or reduction. (R. 31a, 6b, 7b.)

In the case of term loans, the lending bank does not have the flexibility in self-protection available in short-term loans. It is the practice of commercial banks to incorporate provisions in the note or lending agreement covering term loans substantially the same credit requirements the banks would have insisted on in considering the granting of a short-term loan or its renewal. (R. 31a, 6b, 10b-11b, 14b.)

The Curtis notes and loan agreement were typical of term loan transactions and the provisions of the loan agreement were substantially the same as those used in such agreements. (R. 32a.) The procedures followed in handling the loans made to taxpayer pursuant to the loan agreement were the same as those observed generally by the lending bank with respect to commercial loans and the loans were carried in the bank's loan portfolio. (R. 5a-6a.)

REASONS FOR NOT GRANTING THE WRIT.

1. The obligations of Curtis were promissory notes evidencing conventional bank loans and had neither the form nor the basic characteristics of debentures and other investment securities.

2. There is no conflict whatever between Courts of Appeals as to the taxability of obligations such as the Curtis notes.

3. The fact that there may be a conflict between the *Leslie* decision (in which this Court has granted certiorari) and other decisions involving obligation held to be debentures presents no reason for granting certiorari in this case.

ARGUMENT.

Respondent opposes the petition for certiorari because it believes the *Curtis* case was correctly decided on the facts and is not entangled in the "confusion and contrariety of result obtaining among the lower courts". (Petition, p. 9.) Our position is that this case belongs to a category of cases, illustrated by *Niles-Bement-Pond Co. v. Fitzpatrick*, 213 F. 2d 305 (C. A. 2, 1954) (herein called the "Niles Group") which have been properly decided in favor of taxpayers with consistent results,[1] and, because of substantial factual differences, there is no conflict between the cases in the Niles Group and cases in any other groups. There are substantial differences of fact between this, the *Curtis* case, and *United States v. Leslie Salt Co.*,[2] No. 74, October Term, 1955, in which this Court has granted certiorari. Whatever the merits of the *Leslie* case may be, it is not in the same factual category as the *Curtis* case. For the same reasons, we do not believe the Supreme Court needs this case before it "to provide a basis for full exploration and clarification of this widespread problem" (Petition, p. 11).

The petitioner, by its abbreviated petition and cross references, has remitted us to its *Leslie* petition for a full understanding of its reasons for requesting certiorari here. To answer responsively we must, perforce, analyze both petitions in relation to this case and answer the combined distillates.

In its *Leslie* petition, petitioner states that its failure to seek certiorari in previous cases was due to its earlier supposition that "the varying decisions in this area could somehow be reconciled in terms of variations in the factual

1. The only exception known to counsel is *S. S. Pierce Co. v. United States*, 127 F. Supp. 396 (D. C., Mass, 1954) now on appeal in the First Circuit and discussed below at p. 12.

2. Reported at 218 F. 2d 91 and 110 F. Supp. 680.

composites they presented." (p. 14) We believe petitioner's supposition was correct and its hopes have been realized in the evolution of the decisions in the Niles Group and the decisions in another group (herein called GMAC Group) in which *General Motors Acceptance Corporation v. Higgins*, 161 F. 2d 593 (C. A. 2, 1947), certiorari denied 332 U. S. 810, is the lead-off case. As shown below, the guiding principles sought by petitioner are already established by the decisions in the Niles and GMAC Groups. The continuing problem is one of evaluating particular instruments in terms of the stamp tax statute. The Niles Group, including the *Curtis* case, is well over on the promissory note (i.e. the non-taxable) side of the controversy. The problem in the *Leslie* case is whether it and similar cases in the GMAC Group belong in some other group which also lies on the note or non-taxable side of the controversy. The problem of reconciling it does not involve reconciliation of the *Curtis* case.

The pertinent cases in this area grew out of a campaign initiated by the Treasury Department in 1948 after the Court of Appeals (Second Circuit) decided the *GMAC* case. Previously no substantial difficulty was encountered in resolving questions whether particular instruments were promissory notes and not taxable, or taxable instruments. The Treasury Department had consistently ruled that only instruments in registered form or with interest coupons attached were taxable. Basically this meant corporate securities in their commonly recognized form.

Encouraged by the *GMAC* case and some unnecessarily expansive language in the opinion, the petitioner began its campaign to tax all instruments representing term loans by banks and comparable lending operations by other institutions such as insurance companies. The gist of the contention is that term loan notes, as distinguished from ordinary ninety day notes and the like, are taxable merely because of their maturities and because the lender's credit protection is in a written agreement instead of through the

administrative procedures which banks use in policing credit in the shorter loans. There the risk of non-renewal by the bank is in itself an effective disciplinarian. Out of this campaign came the GMAC and Niles Groups.

The *Niles* case (decided in 1954) was not the first to reject the petitioner's claim,[3] but it has special significance because it presented to the Court the first opportunity to pare its *GMAC* opinion down to the necessities of that case. And that the Court forthwith proceeded to do. A comparison of the facts in the two cases and certain fundamental excerpts from the opinion in the *Niles* case show well the basis of cleavage.

GMAC "sold" 84 notes, in denominations ranging from $100,000 to $1,000,000, aggregating $25,000,000, at negotiated prices, including a premium, to seven insurance companies and one investment banking house, who certified they were buying for investment. The notes were dressed up in form and appearance as are corporate securities sold in the investment market. Some were in bearer form and others payable to named payees. They were issued in series and numbered, had maturities of from 4½ to 5 years, were not amortizable, and were redeemable at a premium. To assure a secondary market to the purchasers, provision was made that, at the holder's option, GMAC would exchange the original notes for smaller denominations. The Court held that the "notes" were taxable debentures.

The *Niles* case involved a term bank loan of $3,125,000 repayable in quarterly installments over seven years. Each installment was evidenced by a separate unsealed promissory typewritten note. All notes were identical except for amount, the maturity, and interest rate, and referred to a loan agreement containing restrictions and covenants typical in term bank loans and designed for credit protec-

3. *Belden Mfg. Co. v. Jarecki*, (C. A. 7, 1951), *Allen v. Atlantic Metallic Casket Co.*, (C. A. 5, 1952), *United States v. Ely & Walker Dry Goods Co.*, (C. A. 8, 1953), *Shamrock Oil & Gas Co. v. Campbell*, (D. C. Texas, 1952) cited below at p. 9.

tion. Confronted with its prior *GMAC* decision, the Court of Appeals emphasized the distinction between investment securities and commercial loan transactions, stating (p. 311):

> "We find here no such combination of factors as led the Court in the General Motors case to hold the promissory notes there in question taxable as debentures. We hold that the transaction in this case was a straightforward commercial loan, and that these promissory notes did not partake of the character of debentures."
>
> . . . . . .
>
> "In holding that this combination of factors, and others already referred to, put the GMAC notes 'in a class apart from ordinary commercial notes and into the category of debentures . . .', our Court stressed the investment nature of the transaction. To be sure, a bank as well as an insurance company in a sense intends to invest when it lends money, whether the transaction be called a loan, a private placement, or a public issue. But the classic feature demanded of an investment instrument is ready marketability, and that is what the GMAC notes had, and what the Niles-Bement notes did not have. *And all the cases which have considered the matter appear to have read the General Motors case, as we do, as holding that only those instruments having the characteristics of an investment security fall within the terms of Section 1801.*" (Italics supplied.)

The Courts below in the *Curtis* case and other cases have adopted the *Niles* reasoning in dealing with term loans.

The Niles and GMAC Groups, respectively, follow the patterns of their titular cases.

The Niles Group.

All the cases in the Niles group[4] involved term bank loans except the *Atlanta* and *Motor Finance* cases where the lenders were insurance companies (*Motor Finance* also included a bank loan). All involved facts similar to the *Niles* case, the variations being in amounts, maturities, rates of interest and amortization. The notes were informal, and were not readily marketable for the simple reason that they represented bank loans or equivalent. Although the notes could be prepaid, they were not callable or redeemable in the manner of corporate securities, nor could the lender require fragmentation for secondary distribution as in the cases in the GMAC Group. The loan agreements were substantially equivalent to the one in the *Niles* case. The *Curtis* case is well within the pattern of these cases. It involves three separate borrowings, aggregating $7,200,000., from nine banks operating under a single loan agreement of the usual term loan type, with regular amortization. In all these cases excepting the *Pierce* case, the courts, including five Courts of Appeals, held the instruments to be promissory notes and not taxable.

---

4. The Niles Group includes, in addition to the *Niles* case itself, the *Curtis* case; *United States v. Ely & Walker Dry Goods Co.*, 201 F. 2d 584 (C. A. 8, 1953); *Belden Mfg. Co. v. Jarecki*, 192 F. 2d 211 (C. A. 7, 1951); *Allen v. Atlanta Metallic Casket Co.*, 197 F. 2d 460 (C. A. 5, 1952); *Shamrock Oil & Gas Co. v. Campbell*, 107 F. Supp. 764 (D. C. Texas, 1952); *Bijou Theatrical Enterprise Co. v. Menninger*, 127 F. Supp. 16 (D. C. E. D. Michigan, 1954) on appeal to C. A. 6; *Motor Finance Co. v. United States*, — F. Supp. — (D. C. N. J., 1954), reported at par. 49,057, Supp. Vol., CCH Fed. Tax Reporter; *Follansbee Steel Co. v. United States*, — F. Supp. — (D. C. W. D. Pa., 1955), reported at par. 49,108, Supp. Vol., CCH Fed. Tax Reporter; *United Air Lines, Inc. v. United States*, — F. Supp. — (D. C. N. D. Ill., 1955), reported at par. 49,088, Supp. Vol., CCH Fed. Tax Reporter on appeal to C. A. 7 and *S. S. Pierce Co. v. United States*, 127 F. Supp. 396 (D. C. Mass., 1954), on appeal to C. A. 1.

The GMAC Group.

All the cases in the GMAC Group[5] involved loans by insurance companies, and, in varying degrees, included factors associated with investment securities. One common feature in all of them is provision for fragmentation, at the lender's option, of the original notes into smaller denominations for secondary distribution, and in some of the cases the borrower can be required to secure the fragmented notes by a trust indenture. Generally, but not invariably, the amounts are larger, the maturities are longer. In some instances the notes were sold at a premium (e.g. *GMAC*) or at a discount (e.g. *General Shoe*), prepayments or redemptions in excess of fixed amortization could be made only at a premium (e.g. *Commercial Credit, General Shoe, Sharon Steel*). The *Stuyvesant* case is in a class by itself. It involves an issue of $100,290,000. of non-negotiable "Income Debenture Certificates", maturing in 1984, by a subsidiary corporation to its parent insurance company. The issue represented the entire cost of the subsidiary's housing project and all but $1000. of its capital. The transaction was feasible only because of the relationship of lender and borrower. In all these cases, excepting the *Leslie* case, the Courts found the instruments were taxable debentures.

We include the *Leslie* case in the GMAC Group because factually it is similar to other cases in it. The *Leslie*

---

5. The GMAC Group includes, in addition to the *GMAC* case itself, *Commercial Credit Co. v. Hofferbert*, 188 F. 2d 574 (C. A. 4, 1951); *Gamble-Skogmo, Inc. v. Kelm*, 112 F. Supp. 872 (D. C. Minn. 1953); *H. Kobacker & Sons Co. v. United States*, 124 F. Supp. 211 (D. C. N. D. Ohio, 1954); *United States v. General Shoe Corp.*, 117 F. Supp. 668 (D. C. M. D. Tenn., 1953), on appeal to C. A. 6; *Stuyvesant Town Corp. v. United States*, 111 F. Supp. 243 (Ct. Claims, 1953), cert. denied, 346 U. S. 864; *Knudsen Creamery Co. of Cal. v. United States*, 121 F. Supp. 860 (D. C. S. D. Cal., 1954); *Sharon Steel Corp. v. United States*, — F. Supp. — (D. C. W. D. Pa., 1955), reported at par. 49,107, Supp. Vol., CCH Fed. Tax Reporter; and the *Leslie* case.

case involves notes for $1,000,000. and $3,000,000. covering separate borrowings from the insurance companies under separate but identical loan agreements. The notes were termed "3¼% Sinking Fund Promissory Note Due February 1, 1964" and had a fifteen year maturity. There was fixed amortization through a sinking fund, the notes were subject to call for additional prepayment without premium in certain limited amounts and otherwise at graded premiums. New notes issued under the fragmentation privilege were to be in coupon form or in registerd form without coupons.

Leslie, in its answer (p. 6) to the petition for certiorari, concedes the *Leslie* case to be in conflict with the *Commercial Credit* case. Our understanding of Leslie's position is that its case is sufficiently dissimilar factually from the *GMAC* case as not to be controlled by it, that the notes initially issued should not be taxed because they may later be replaced by taxable instruments under the fragmentation clause, and that the decisions in the *Commercial Credit* and similar cases are wrong. Our purpose here is not to argue the merits of the *Leslie* claims,—only to point out that factually the *Leslie* case does not belong in the Niles Group. If the Leslie notes and similar instruments are non-taxable, it is because evaluation of their particular ingredients makes them so.

The petitioner let all the cases in the Niles Group except the *Curtis* case pass without seeking certiorari. It had no reason for seeking certiorari in cases in the GMAC group until the *Leslie* case because all had been decided in petitioner's favor. Now the petitioner would make it appear that the cleavage between the Niles and GMAC Groups is based primarily on the ground that the Courts are invalidly making the source of the loan the test of taxability. The petitioner would also make it appear that the only difference between the *Curtis* and *Leslie* cases is the type of lender, and that certiorari should be granted in the *Curtis* case because it has now "become apparent . . . that the

differences between the decisions upholding the stamp tax and those denying its application are differences as to the legal definition of 'debentures' and 'certificates of indebtedness' as these terms are used in the stamp tax statute". (See petition in *Curtis*, p. 10; petition in *Leslie*, pp. 13-15 and footnotes 3-6; compare with our allocation of the same cases on pp. 9 and 10 *supra*).

There are numerous variations in reasoning, and in emphasis on various factors, by the lower Courts on the way to final results in the cases, but the variations are incidental to the evolution that has occurred. We agree that the fact that the lender is an insurance company instead of a bank, standing alone, is not material.[6] But the source of the loan is certainly a factor to be considered for the simple reason that loan departments of commercial banks are not authorized to acquire investment securities, whereas insurance companies are interested in acquiring readily marketable investment securities and instruments designed for acquisition by them tend to fall in that category, as the cases in the GMAC Group show. And the Courts are certainly taking this factor into consideration, as they should.

We challenge the statement that the differences in the results in these cases are based on differences as to the legal definition of "debentures". The only attempt to define the term "debenture" appears in the *GMAC* case. In *GMAC* the Court said that Congress, when it repealed the tax on promissory notes in 1924, repealed only the tax on notes used customarily in day by day commercial transactions of a short time credit character. The same Court reversed this conclusion in the *Niles* decision, but the District Court in the *Pierce* case revived the idea on what ought to be a short life in the First Circuit. Acceptance of the proposition would mean that the statutory term "debenture", through the 1924 repealer, ipso facto absorbed term notes even though debentures were then, as

6. The *Atlanta* and *Motor Finance* cases, *supra*, p. 9, in the Niles Group, involve insurance company loans.

they are now, grouped with bonds and certificates of indebtedness, even though such instruments are listed under the caption "Corporate Securities" in Section 1801 of the 1939 Code, and even though there is nothing in the statute or its legislative history to indicate any such intention. Actually the boundaries of the term are being defined by evaluation of the factual composites in each case, by a process of inclusion and exclusion, just as is regularly done in the judicial process and just as petitioner supposed it would be done. Congress made no attempt to redefine "debentures" in the 1954 Code in the face of these decisions[7]; and we do not understand that the Treasury Department asked it to do so.

Finally, the petitioner asserts that the problem involved in the *Curtis* case is of such importance, and is so widespread, that certiorari should be granted. Certainly the problem is widespread in terms of litigation; the petitioner's campaign has made it so. But the problem is not widespread at all in terms of results.

As noted above, the *Curtis* case is well within the *Niles* group of decisions, which represent the considered conclusions of the Courts of Appeals in the Second, Third, Fifth, Seventh and Eighth Circuits. We believe that the grant of certiorari here is not necessary to the resolution of questions in any other case.

If, as we believe, the *Niles* decision is correct, denial of certiorari here would also have the salutary effect of promptly eliminating ordinary term loans from the arena of litigation and leave the resolution of conflicts in the GMAC Group where it belongs.

---

7. Congress was fully aware of the problem when the Internal Revenue Code of 1954 was under consideration in the Senate: see statement to the Senate Finance Committee by Berthold Muecke, Jr., Esq., at pages 962-965, Part 2 of Hearings before the Committee on Finance, United States Senate, Eighty-third Congress, second session, on HR8300.

CONCLUSION.

It is respectfully submitted that the petition for certiorari should be denied for the foregoing reasons.

FRANCIS H. SCHEETZ,
Attorney for Respondent.

August 17, 1955.